Supreme Court, U.S.
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NO.

IN THE

Supreme Court of The United States

OCTOBER TERM, 1991

PHOENIX MUTUAL LIFE INSURANCE COMPANY,

Cross-Petitioner,

v.

GREYSTONE III JOINT VENTURE,

Cross-Respondent.

ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

CROSS-PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

WHETHER THE ABSOLUTE PRIORITY RULE AS CODIFIED IN CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE PERMITS CONFIRMATION, OVER THE OBJECTION OF AN UNDERSECURED CREDITOR, OF A PLAN OF REORGANIZATION WHICH (A) PROVIDES FOR DISCHARGE OF THE OBJECTING CREDITOR'S UNSECURED CLAIM BY DISTRIBUTING TO THE OBJECTING CREDITOR A MINUSCULE FRACTION OF THE OBJECTING CREDITOR'S UNSECURED CLAIM, BUT (B) VESTS IN THE DEBTOR'S PRINCIPALS THE EXCLUSIVE RIGHT TO RETAIN OWNERSHIP OF THE DEBTOR'S PROPERTY BY CONTRIBUTING CAPITAL, AND (C) PREVENTS THE OBJECTING CREDITOR FROM SUBMITTING A COMPETING PROPOSAL.

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CROSS-PETITION FOR A WRIT OF CERTIORARI

Pursuant to Supreme Court Rule 12.3 Cross-Petitioner Phoenix Mutual Life Insurance Company ("Phoenix") submits this cross-petition for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit ("the Fifth Circuit"), for review of the Fifth Circuit's partial grant of the suggestion for rehearing en banc filed in the Fifth Circuit by Cross-Respondent Greystone III Joint Venture ("Greystone"):

QUESTION PRESENTED

WHETHER THE ABSOLUTE PRIORITY RULE AS CODIFIED IN CHAPTER 11 OF THE UNITED STATES BANKRUPTCY CODE PERMITS CONFIRMATION, OVER THE OBJECTION OF AN UNDERSECURED CREDITOR, OF A PLAN OF REORGANIZATION WHICH (A) PROVIDES FOR DISCHARGE OF THE OBJECTING CREDITOR'S UNSECURED CLAIM BY DISTRIBUTING

TO THE OBJECTING CREDITOR A MINUSCULE FRACTION OF THE OBJECTING CREDITOR'S UNSECURED CLAIM, BUT (B) VESTS IN THE DEBTOR'S PRINCIPALS THE EXCLUSIVE RIGHT TO RETAIN OWNERSHIP OF THE DEBTOR'S PROPERTY BY CONTRIBUTING CAPITAL, AND (C) PREVENTS THE OBJECTING CREDITOR FROM SUBMITTING A COMPETING PROPOSAL.

STATEMENT REGARDING PARTIES

The parties to this case are listed in the petition ("Greystone's petition") for a writ of certiorari filed in this Court by Greystone and the brief ("Phoenix's brief") filed in this Court by Phoenix in opposition to Greystone's petition.

OPINIONS BELOW

The opinion of the Fifth Circuit partially granting Greystone's suggestion for rehearing appears beginning at page A-3 of the appendix to Greystone's petition and is published at 948 F.2d at 142. The opinion of the Fifth Circuit as modified on rehearing is published at 948 F.2d 134. The original opinion of the Fifth Circuit appears beginning at page A-6 of the appendix to Greystone's petition. The opinion of the United States District Court for the Western District of Texas, Austin Division ("the District Court"), appears beginning at page A-42 of the appendix to Greystone's petition and is published at 127 B.R. 138. The opinion of the United States Bankruptcy Court for the Western District of Texas, Austin Division ("the Bankruptcy Court"), appears beginning at page A-72 of the appendix to Greystone's petition and is published at 102 B.R. 560.

JURISDICTION

The Fifth Circuit's original decision was dated November 19, 1991. The Fifth Circuit's decision partially granting Greystone's suggestion for rehearing was dated February 27, 1992. Greystone's petition was filed in this Court on May 27, 1992. This cross-petition is filed within 30 days of May 27, 1992. Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

ADDITIONAL PERTINENT STATUTORY PROVISIONS

In addition to the statutes quoted in Greystone's petition and Phoenix's brief, the following statute is pertinent:

"11 U.S.C. § 1129 Confirmation of plan

* * *

(b)(1) If all of the applicable requirements of Subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

* * *

(B) With respect to a class of unsecured claims —

(i) The plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) The holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property."

STATEMENT OF THE CASE

A. Relevant facts.

As stated in Greystone's petition and Phoenix's brief, Greystone's principal asset was an office building ("the building") located in Austin, Texas. Phoenix was the owner and holder of a promissory note ("the note") in the original principal amount of $8.8 million executed by Greystone. Payment of the note was secured by a deed of trust ("the deed of trust") encumbering the building.

On the eve of a scheduled foreclosure of the deed of trust, Greystone commenced in the Bankruptcy Court a voluntary case ("Greystone's Chapter 11 case") for relief under Chapter 11 of the United States Bankruptcy Code ("the Code"). As of the commencement of Greystone's Chapter 11 case, the unpaid balance of principal and interest owing on the note was $9,300,773.60. The Bankruptcy Court in Greystone's Chapter 11 case determined that the value of the building was $5,825,000. Thus, Phoenix filed in Greystone's Chapter 11 case proofs of a secured claim ("Phoenix's secured claim") in the amount of $5,825,000 and an unsecured claim ("Phoenix's unsecured claim") of $3,475,773.60.

Greystone proposed in Greystone's Chapter 11 case a plan of reorganization ("Greystone's plan") which contemplated (a) discharging creditors' unsecured claims, including Phoenix's unsecured claim, by distributing to each unsecured creditor 3.82% of the amount of each unsecured creditor's claim; and (b) vesting in Greystone's principals the exclusive right to retain 100% of the ownership of the building by contributing a capital infusion of $500,000. Phoenix voted Phoenix's secured claim and Phoenix's unsecured claim to reject Greystone's plan, and opposed confirmation of Greystone's plan on the ground, *inter alia*, that Greystone's plan violated the absolute priority rule by allowing Greystone's principals to retain ownership of the building without fully paying Phoenix's unsecured claim. A class consisting of unsecured claims aggregating $10,000 held by Greystone's trade creditors ("the trade creditors") voted to accept Greystone's plan. At the hearing on confirmation of Greystone's plan the Bankruptcy Court rejected Phoenix's request to propose and fund a plan of reorganization which would fully pay all other creditors' claims and provide capital for repairs and maintenance of the building.

B. The decisions below.

The Bankruptcy Court confirmed Greystone's plan, *In re Greystone III Joint Venture*, 102 B.R. 560 (Bankr. W.D. Tex. 1989), reasoning, among other things, that an exception to the absolute priority rule pursuant to which a "junior interest holder might retain an interest in the enterprise even though senior classes were not fully paid provided the junior interest holder had made a cash infusion" 102 B.R. at 573 was "still good law, as it represents nothing more than an extension of the fair and equitable concept to embrace the need for new capital for the venture" 102 B.R. at 575.

The District Court affirmed the Bankruptcy Court, *In re Greystone III Joint Venture*, 127 B.R. 138 (W.D. Tex. 1990), expressing agreement "with the Bankruptcy Judge's determination that" the exception to the absolute priority rule "remains

vital," and concluding that the Bankruptcy Court's factual determination "that the most feasible source of funding was from the current owners of the partnership, rather than from Phoenix" was not clearly erroneous, 127 B.R. at 142-43.

The Fifth Circuit initially reversed those determinations of the Bankruptcy Court and District Court, *Phoenix Mutual Life Insurance Company v. Greystone III Joint Venture (In re Greystone III Joint Venture)*, (5th Cir. 1991) (Appendix to Greystone's petition, pp. A-6 to A-41), holding, *inter alia*, that (a) neither "in the Code's language, nor in the context of a previous, different reorganization law, nor in legislative history, nor in policy is there room for a 'new value exception' to the absolute priority rule . . . " (Appendix to Greystone's petition, p. A-40); and (b) the Bankruptcy Court "erred in refusing to consider Phoenix's proposed equity contribution along with that of former equity" (Appendix to Greystone's petition, p. A-41). However, on rehearing the Fifth Circuit withdrew those holdings, emphasizing that the Bankruptcy Court's "opinion on the 'new value exception' to the absolute priority rule has been vacated and we express no view whatever on that part of a bankruptcy court's decision" 948 F.2d at 142.

REASONS FOR GRANTING THE WRIT

A. *Review on certiorari of the issue presented in this cross-petition is warranted pursuant to Supreme Court Rules 10.1(a) and (c) because the issue constitutes an extremely important question of federal law which has not been, but should be, settled by this Court, and is the subject of conflicting decisions by United States Courts of Appeals.*

1. *Lower courts are hopelessly divided on the issue, and the issue is the subject of conflicting United States Court of Appeals decisions.*

In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203, n. 3 (1988), this Court discussed, but did not decide, the extent, if

any, to which codification in 1978 of the absolute priority rule in the Code incorporated an exception to the absolute priority rule which had been suggested by dicta in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939); however, this Court in *Ahlers* observed that whether Congress "meant to retain the *Los Angeles Lumber* exception to the absolute priority rule when it codified the rule in Chapter 11" was "a proposition that can be debated" 485 U.S. at 205, and that "the continuing vitality of the *Los Angeles Lumber* exception" was a "question which has divided the lower courts since passage of the Code in 1978" 485 U.S. at 203-204, n. 3. That division in the lower courts has proliferated enormously since this Court's *Ahlers* decision, *see Travelers Insurance Company v. Bryson Properties (In re Bryson Properties XVIII)*, ___ F.2d ___, 22 BCD 1391, 1394-95 (4th Cir. 1992) (Holding that because the "exclusive right to contribute constitutes 'property' . . . which was received or retained on account of a prior interest", even if "some limited new capital exception were viable under the Bankruptcy Code it would not be so expansive as to apply under the facts of this case," in that "here the Debtors have carried their opportunity for self-dealing too far"); *Kahm & Nate's Shoes v. First Bank of Whiting*, 908 F.2d 1351, 1360-63 (7th Cir. 1990) (Questioning whether the exception survived passage of the Code but declining to decide the issue); *In re Ribbs Auto Sales, Incorporated*, ___ B.R. ___, 1992 WL 105619, Slip Opinion p. 5 (Bankr. E.D. Va. May 14, 1992) (Opining that the exception did not survive passage of the Code); *In re SLC Limited V*, 22 BCD 1081, 1082-1085 (Bankr. D. Utah 1992) (Holding that the exception survived passage of the Code); *In re Professional Development Corp.*, 22 BCD 441, 442-43 (Bankr. W.D. Tenn. 1991) (Holding that the exception survived passage of the Code); *In re Tallahassee Associates, L.P.*, 132 B.R. 712, 716-718 (Bankr. W.D. Pa. 1991) (Holding that the exception survived passage of the Code); *Piedmont Associates v. Cigna Property & Casualty Insurance Co.*, 132 B.R. 75, 78-79 (N.D. Ga. 1991) (Holding that the exception did not survive passage of the Code); *In re Drimmel*, 135 B.R. 410, 415-417 (D. Kan. 1991)

(Holding that the exception did not survive passage of the Code); *In re Bjolmes Realty Trust*, 134 B.R. 1000, 1004-1008 (Bankr. D. Mass. 1991) (Holding that the exception survived passage of the Code); *In re Triple R Holdings, L.P.*, 134 B.R. 382, 384-387 (Bankr. N.D. Cal. 1991) (Holding that the exception survived passage of the Code); *In re Woodscape Limited Partnership*, 134 B.R. 165, 168-175 (Bankr. D. Md. 1991) (Holding that the exception survived passage of the Code); *In re Outlook/Century, Ltd.*, 127 B.R. 650, 653-658 (Bankr. N.D. Cal. 1991) (Holding that the exception did not survive passage of the Code); *In re Lumber Exchange Ltd. Partnership*, 125 B.R. 1000, 1006-1008 (Bankr. D. Minn. 1991) (Holding that the exception did not survive passage of the Code); *In re Pullman Construction Industries, Inc.*, 107 B.R. 909, 946-48 (Bankr. N.D. Ill. 1989) (Holding that the exception survived passage of the Code).

The issue is, moreover, the subject of conflicting decisions by United States Courts of Appeals; the Fourth Circuit's holding in *Bryson Properties XVIII, supra*, conflicts with the Sixth Circuit's pre-*Ahlers* holding in *Teamsters National Freight Industries Negotiating Committee v. U.S. Truck Company (In re U.S. Truck Company, Inc.)*, 800 F.2d 581, 587-88 (6th Cir. 1986) that the exception remained viable after passage of the Code.

Although the Fifth Circuit on rehearing withdrew those portions of the Fifth Circuit's original *Greystone* opinion which addressed the viability of the exception after passage of the Code, the issue was nevertheless "in" the Fifth Circuit for purposes of this Court's jurisdiction under 28 U.S.C. §1254(1), *Nixon v. Fitzgerald*, 457 U.S. 731, 742 (1982). Moreover, because the issue is a "pure issue of law" which is "serious and unsettled", concerns of judicial economy fully warrant this Court's resolution of the important issue, *Nixon, supra*, 457 U.S. at 743 and n. 23.

2. *The better reasoned decisions, including the Fifth Circuit's original Greystone opinion, demonstrate that, at least to the extent contemplated by Greystone's plan, the exception to the absolute priority rule did not survive passage of the Code.*

This Court stated in *Ahlers*, 485 U.S. at 202, that the "absolute priority rule 'provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property'" under a reorganization plan; that the rule "had its genesis in judicial construction of the undefined requirement of the early bankruptcy statute that reorganization plans be 'fair and equitable'"; that the rule "has since gained express statutory force, and was incorporated into Chapter 11 of the Bankruptcy Code adopted in 1978. *See* 11 U.S.C. § 1129(b)(2)(B)(ii) . . ."; and that under "current law, no Chapter 11 reorganization plan can be confirmed over the creditors' legitimate objections . . . if it fails to comply with the absolute priority rule." The dicta in *Case v. Los Angeles Lumber Products Co.*, *supra*, 308 U.S. at 121-122, suggesting an exception to the absolute priority rule, stated that there were "circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor" by a "contribution in money or money's worth, reasonably equivalent in view of all of the circumstances to the participation of the stockholder." This Court observed in *Ahlers*, 485 U.S. at 205, that whether "Congress meant to retain the *Los Angeles Lumber* exception to the absolute priority rule when it codified the rule in Chapter 11" was "a proposition that can be debated." Better reasoned decisions, including the Fifth Circuit's original *Greystone* decision, demonstrate that, at least to the expansive extent contemplated in Greystone's plan, Congress did not retain the exception in the Code's codification of the absolute priority rule.

First, the Code's clear and unambiguous codification of the absolute priority rule does not mention the exception. As Greystone's petition (p. 15) staunchly asserts, "The plain meaning of legislation should be conclusive, except in the rare cases in which

the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters" *see United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) ("The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters'"); *In re Outlook/Century, Ltd., supra*, 127 B.R. at 657 (Congress' adoption of a statutory definition of the absolute priority rule that "contains no new value exception . . . constitutes strong evidence that Congress intended to eliminate the new value exception to the absolute priority rule").

Moreover, the Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's petition, p. A-34) appropriately observed that when *Case* was decided, a plan could be confirmed only if the plan was both (a) fair and equitable, and (b) accepted by each class of creditors, *Case v. Los Angeles Lumber Co., supra*, 308 U.S. at 114, n. 6, but under the Code a plan accepted by all classes need not satisfy the statutorily defined absolute priority rule. Thus, any plan which could have been confirmed when *Case* was decided could be confirmed under the Code regardless of whether the plan complied with the absolute priority rule; furthermore, because Greystone's plan was not accepted by each class of creditors, Greystone's plan could not have been confirmed when *Case* was decided regardless of whether Greystone's plan complied with the absolute priority rule. *See In re Outlook/Century Ltd.*, 127 B.R. 650, 657 (To cite *Case* as "supporting a new value under Section 1129(b)(2)(B) is to cite the language of the decision without reference to the context in which it arose"). Thus, the Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's petition, p. A-34) aptly stated that the "increased flexibility" in the Code renders "the *Case* exception unnecessary."

The Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's petition, p. A-35) also appropriately reasoned that the use of the term "includes" in the definition of "fair and

equitable" in Section 1129(b) of the Code could not support the argument that the exception survived passage of the Code because the statute sets a "minimum standard for a fair and equitable plan" and the exception would dilute "that minimum requirement."

Additionally, the Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's opinion, pp. A-35 to A-36) appropriately rejected the argument that if "'old equity' infuses new money into the Debtor, it is not retaining its ownership 'on account of' its old equity status"; as the Fifth Circuit's original *Greystone* opinion stated, Greystone "intends to prevent creditors from acceding to ownership of the property on account of Greystone's unique status as an old equity contributor to the plan" and Greystone "desired to prevent a competitive auction of the property, at which Phoenix could credit bid, precisely because of Greystone's old equity status." *See also Travelers Insurance Company v. Bryson Properties XVIII (In re Bryson Properties XVIII), supra,* F.2d , 22 BCD at 1394-95 ("The question is whether the equityholders receive anything 'on account of' their prior interest . . . In the proposed plan the equityholders have given themselves not only the exclusive right to contribute, but the right to return of the new capital prior to Travelers' recovery of its unsecured claim . . . This exclusive right to contribute constitutes 'property' under Section 1129(b)(2)(B)(ii) which was received or retained on account of their prior interest . . . Here, the Debtors have carried their opportunity for self dealing too far").

Furthermore, the Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's petition, p. A-37) aptly rejected arguments that the exception could be an equitable variation from the absolute priority rule because, as this Court held in *Ahlers*, whatever "equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code" 485 U.S. at 206.

Finally, the Fifth Circuit's original *Greystone* opinion (Appendix to Greystone's petition, pp. A-37 to A-38) appropriately disagreed with "the assumption" that the Code "permits a nonconsensual plan to 'sell' the debtor to its old equity owners" because this assumption "flies in the face of the creditor control principal (sic) embodied in Chapter 11 and accepted by *Ahlers*." In *Ahlers* this Court indeed clearly embraced the creditor control concept by stating that (a) the determination of whether creditors are "better off" if a plan is confirmed is "for the creditors to make" and when creditors object to a proposed plan this is "their prerogative under the Code, and courts applying the Code must effectuate their decisions", 485 U.S. at 207; and (b) whether the value of an insolvent debtor's property "is 'present or prospective, for dividends or only for purposes of control' a retained equity interest is a property interest to 'which the creditors [are] entitled . . . before the stockholders [can] retain it for any purpose whatever.'" 485 U.S. at 208, citing *Northern Pacific Railway Co. v. Boyd*, 228 U.S. 482, 508 (1913). *See also In re Outlook/Century, Ltd., supra*, 127 B.R. at 653-54 ("The proposed contribution of capital cannot be considered a 'purchase' in which the partners will receive equity in debtor wholly independent of their existing partnership interest, because it is not an open market transaction. Other potential investors are not permitted to participate. The 'price' for the equity interest in debtor is fixed by debtor's plan; there is no opportunity for persons other than the existing partners to overbid."). Accordingly, the determination in the Fifth Circuit's original *Greystone* opinion regarding the extent to which the exception survived passage of the Code was clearly correct and erroneously withdrawn.

CONCLUSION

For the reasons stated in Phoenix's brief, Greystone's petition should be denied. However, if this Court grants Greystone's petition, this Court should also grant this cross-petition and resolve the important issue of federal law which is the subject of a conflict in the decisions of the United States Courts of Appeals and of hopeless division among the lower courts.

Respectfully submitted,

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BRIEF IN RESPONSE

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QUESTION PRESENTED

Whether 11 U.S.C. § 1129(b) permits an old equity holder to receive an interest in the reorganized Debtor based upon a new contribution of money or money's worth over the objection of a class of unsecured claims?

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GREYSTONE III JOINT VENTURE
Cross-Respondent.

CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF IN RESPONSE

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Greystone III Joint Venture ("Greystone"), the Cross-Respondent herein, submits this Brief in Response to Cross-Petition for Writ of Certiorari and joins Cross-Petitioner in requesting that a Writ of Certiorari be issued in this matter (as well as in case number 91-1902) ("the Greystone Petition").

STATEMENT REGARDING PARTIES

The parties to this case are listed in the Petition for a Writ of Certiorari filed in this Court by Greystone in case number 91-1902.

OPINIONS BELOW

The Opinion of the Fifth Circuit granting re-hearing in part appears at page A-3 of the Appendix to Greystone's Petition and is published at 948 F.2d 142. The Opinion of the Fifth Circuit as modified on re-hearing is published at 948 F.2d 134. The original Opinion of the Fifth Circuit appears beginning at page A-6 of the Appendix to Greystone's Petition. The Opinion

of the United States District Court for the Western District of Texas, Austin Division, appears beginning at page A-42 of the Appendix to Greystone's Petition and is published at 127 B.R. 138. The Opinion of the United States Bankruptcy Court for the Western District of Texas, Austin Division, appears beginning at page A-72 to the Appendix to Greystone's Petition and is published at 102 B.R. 560.

JURISDICTION

The Fifth Circuit's original opinion was dated November 19, 1991. The Fifth Circuit's opinion granting re-hearing in part was dated February 27, 1992. Greystone's Petition was filed in this Court on May 27, 1992. Phoenix Mutual Life Insurance Company ("Phoenix") filed its Cross-Petition within thirty days of May 27, 1992. Jurisdiction of this Court was invoked pursuant to 28 U.S.C. § 1254(1).

STATEMENT OF THE CASE

A. Relevant Facts.

Greystone III Joint Venture was formed on August 30, 1983 for the purpose of developing an office building located in Austin, Texas. The project is the Debtor's primary asset. Phoenix Mutual Life Insurance Company is the holder of a Promissory Note in the original principal amount of $8.8 million dated September 27, 1985. The Note is secured by a Deed of Trust lien upon the real property and an assignment of rents. The Debtor sought protection under Chapter 11 on April 4, 1988 after Phoenix posted the property for foreclosure.

At the time of the filing the Debtor owed approximately $145,000.00 in ad valorem taxes, $9.3 million to Phoenix Mutual Life insurance Company, $10,000.00 in trade debt and $20,000.00 in security deposits. The debt to Phoenix was non-recourse, so that liability was limited to the value of the property.

On June 13, 1988, the Debtor filed its Plan and Disclosure Statement. On September 7, 1988, the Debtor filed a First Amended Plan and Disclosure Statement. On September 28, 1988, the Debtor filed its Second Amended Plan and Disclosure Statement. Also on September 28, 1988, the Bankruptcy Court conducted a hearing at which the Disclosure Statement was approved.

The Debtor's Second Amended Plan of Reorganization established classes for the ad valorem taxes, the secured claim of Phoenix, the non-recourse deficiency claim of Phoenix, the trade debt and the security deposits. The Plan proposed that the Debtor's partners would inject $500,000.00 in new capital to fund a Plan of Reorganization. The new capital was to be used to make payments under the Plan and to provide a reserve for capital improvements in debt service to Phoenix. The Plan provided that the ad

valorem taxes would be paid in full without penalty or interest. The Plan (as modified at confirmation) provided for restructuring the secured debt to Phoenix to provide for payments based upon a thirty-year amortization at an eleven (11) percent interest rate, with a 7-year balloon. At the confirmation hearing, Phoenix stipulated to the thirty-year amortization, the eleven (11) percent interest rate and the 7-year balloon.

The Plan provided that the deficiency claim of Phoenix would "be paid $200,000.00 (or 3.82%) in full satisfaction of its claim on the Effective Date of the Plan..." The Plan provided that trade creditors would receive 3.82% of their claims under the Plan, but that they would be permitted to collect the remainder of their claims from the general partners under State law. The Plan also provided that the security deposit creditors would receive 25% of their deposits on the Effective Date of the Plan, with fifty (50) percent of their claims being

paid pursuant to the terms of their lease. However, the Plan did not release the general partners from any additional liability to the security deposit creditors.

The Plan proposed to cancel the old interest of the Debtor's partners and to issue new partnership interests based upon the capital contribution.

The Plan was submitted to creditors for voting. The trade creditors, security deposit creditors and partners voted affirmatively to accept the Plan. The taxing authorities did not vote and were deemed to accept the Plan. Phoenix voted to reject the Plan.

The Debtor's Plan was originally set for confirmation on November 28, 1988. However, this setting was continued at the request of Phoenix. The hearing was ultimately held on January 27, 1989. At the commencement of such hearing, Phoenix sought leave of Court to file a competing Plan of Reorganization. Leave of court was necessary pursuant to Bankruptcy

Rule 3016(a), which provides that once an order has been entered approving a Disclosure Statement, a Plan may not be filed without leave of court.

The proposed Phoenix Plan contained several significant features. Phoenix proposed to pay administrative claims, but only to the extent of $15,000.00. Phoenix proposed to pay tax claims (which were a superior lien upon the property), but only to the extent of $145,000.00. Phoenix proposed to pay trade creditor claims to the extent of $10,000.00. The Plan provided for Phoenix to take title to the real property either through non-judicial foreclosure, a deed in lieu of foreclosure or through sale free and clear of liens. The Phoenix Plan proposed to assume various leases, but provided that its liability for curing defaults would be limited to $5,000.00. The interest of the Debtor's equity holders was to be cancelled. The equity holders were not given the opportunity to submit competitive bids.

The Phoenix Plan was also conditioned upon confirmation occurring not later than March 31, 1989.

The Court denied leave to file the Phoenix Plan and proceeded with the confirmation hearing upon the Debtor's Plan. On June 5, 1989, the Court entered its Decision on Confirmation of Debtor's Second Amended Plan of Reorganization, which confirmed the Debtor's Plan. By this date, the Phoenix Plan had expired according to its own terms.

B. The Decisions Below.

The Bankruptcy Court confirmed the Debtor's Second Amended Plan of Reorganization. *In re Greystone III Joint Venture*, 102 B.R. 560 (Bankr.W.D.Tex. 1989). The Bankruptcy Court ruled that the "new value" doctrine of *Case v. Los Angeles Lumber Products Company*, 308 U.S. 106, 60 S.Ct. 1, 84 L.Ed. 110 (1939) was still viable under the Bankruptcy Code. The Bankruptcy Court examined the Debtor's

Plan under each of the prongs of the test established in *Case v. Los Angeles Lumber* and determined that the Debtor's Plan provided for an infusion of new money which was necessary, substantial and reasonably equivalent to the interest being retained.

On appeal, the United States District Court affirmed the Bankruptcy Court. *In re Greystone III Joint Venture*, 127 B.R. 138 (W.D.Tex. 1990). The District Court agreed "with the Bankruptcy Judge's determination that the *Case* exception remains vital." The District Court also found that the Plan satisfied the absolute priority rule.

The Fifth Circuit initially ruled that the exception to the absolute priority rule did not survive an enactment of the Bankruptcy Code. However, on Motion for Rehearing, the Fifth Circuit withdraw this portion of its Opinion and stated that it expressed no opinion on the vitality of the exception. Judge Edith Jones

dissented from the opinion granting re-hearing in part. Judge Jones stated that construction of the Bankruptcy Code had been clouded by the Supreme Court's Opinion in *Dewsnup v. Timm*, ___ U.S.____, 112 S.Ct. 773, __L.Ed.____ (1992) and that the Fifth Circuit should have retained its original ruling.

REASONS FOR GRANTING THE WRIT

Cross-Respondent Greystone III Joint Venture agrees with Cross-Petitioner Phoenix Mutual Life Insurance Company that the Court should grant the Writ in this case. However, in order to consider the Writ in this case, the Court must also grant Writ in Case Number 91-1902, *Greystone III Joint Venture, Petitioner v. Phoenix Mutual Life Insurance Company, Respondent.* Greystone contends that both the issues of classification under § 1122 and absolute priority under § 1129(b) should be addressed by this Court. Both issues are necessary for a complete resolution of this case. As

stated in Greystone's Petition and below, the issues in the two Petitions present significant questions which have divided the Courts of Appeals. Under Supreme Court Rules 10.1(a) and (c), both Petitions for Writ of Certiorari warrant this Court's consideration.

A. There are significant reasons for granting the Writ, including resolving a split of authority among the Circuit Courts of Appeals.

This case presents the Court with the opportunity to determine the continuing vitality of *Case v. Los Angeles Lumber Products Co.* The Court previously granted a writ of certiorari in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988), but failed to reach the issue. In *Ahlers*, this Court ruled that a contribution of "labor, experience and expertise" was not money or money's worth. In this case, the contribution consists of $500,000.00 of actual money which was on deposit on the date the

confirmation order was entered. The Bankruptcy Court found that the contribution was substantial, necessary and reasonably equivalent. Thus, the present case directly addresses the issue which was left open in *Ahlers*.

In *Ahlers*, this Court noted that the *Los Angeles Lumber* exception had divided the lower Courts since passage of the Bankruptcy Code in 1978. The Courts of Appeals remain seriously divided. *Matter of Snyder*, ___F.2d ____, 1992 W.L. 156687 (7th Cir. 1992) (suggesting that exception exists but declining to reach issue); *Kham and Nates Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351 (7th Cir. 1990) (suggesting that exception does not exist but declining to reach issue); *Matter of Stegall*, 865 F.2d 140 (7th Cir. 1989) (existence of exception is an open question); *In re Potter Material Service, Inc.*, 781 F.2d 99 (7th Cir. 1986) (exception satisfied by facts of case); *In re Bryson Properties, XVIII*,

961 F.2d 496 (4th Cir. 1992) (exception does not exist); *Matter of Greystone III Joint Venture*, 948 F.2d 134 (5th Cir. 1991) (exception is open question); *In re Anderson*, 913 F.2d 530 (8th Cir. 1990) (suggesting that exception exists but declining to reach issue); *In re Ahlers*, 794 F.2d 388 (8th Cir. 1986), (exception exists), *rev'd.*, 485 U.S. 197 (open question); *In re U. S. Truck Company, Inc.*, 800 F.2d 581 (6th Cir. 1986) (exception satisfied by facts of case).

Greystone agrees with Phoenix Mutual that although the Fifth Circuit withdrew those portions of its original Opinion which addressed the viability of the exception, that this Court has jurisdiction to consider the issue. Greystone also concurs that the issue is a "pure issue of law." The Bankruptcy Court's factual findings that the exception was satisfied remain undisturbed by the subsequent rulings.

B. Upon granting the Writ, the Court should

find that the Debtor's Plan was fair and equitable and should have been confirmed.

The absolute priority rule is a definition of the term "fair and equitable" in the context of a bankruptcy reorganization. According to Phoenix, the "better reasoned" cases interpret the absolute priority rule to prevent old equity from participating in a Plan where a dissenting class of unsecured creditors does not receive payment in full. The question is one of congressional intent, specifically, whether Congress intended to exclude participation based upon a fresh contribution of capital when it used the term "fair and equitable" in § 1129(b). Under this Court's precedents, it is clear that Congress did not intend to repeal the "new value" doctrine when it adopted the Bankruptcy Code.

This Court has provided useful guidelines for determining congressional intent under the Bankruptcy Code. Statutory interpretation begins with the language

of the statute itself. *Pennsylvania Department of Public Welfare v. Davenport*, 495 U.S. 552, 109 L.Ed. 2d 588, 110 S.Ct. 2126 (1990). The plain meaning of legislation should be conclusive, except in the rare cases in which the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 103 L.Ed. 2d 290, 109 S.Ct. 1026 (1989). However, statutes should not be read to prohibit or require matters outside their text in the absence of legislative history, established judicial construction or some other accepted method for interpreting the statutory text.

This Court has indicated that practice under the Bankruptcy Act is helpful in interpreting the Code.

> When Congress amends the Bankruptcy laws, it does not write "on a clean slate." (citation omitted) Furthermore, this Court has been reluctant to accept arguments

> that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history.

Dewsnup v. Timm, ___ U.S. _____, 112 S.Ct. 773, 779 (1992).

In the present case, both the statutory language and the practice under the Bankruptcy Act indicate that Congress did not intend to repeal the new capital doctrine.

The absolute priority rule is a definition of the term "fair and equitable." § 1129(b) of the Code provides:

> (2) For the purpose of this subsection, the condition that a Plan be fair and equitable with respect to a class <u>includes</u> the

following requirements:

. . .

(b) with respect to a class of unsecured claims --

(i) the Plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

According to Phoenix, this language is clear and

unambiguous and excludes any participation based on a new capital contribution. However, the statutory language contains no such exclusion. Rather, the language establishes two conditions under which a plan may be fair and equitable. One situation is where dissenting unsecured creditors are paid in full. A second condition is where junior interests do not receive or retain any property on account of their former interests. The statutory language does not prevent participation in a reorganization on some other basis. *In re Apex Oil Co.*, 118 B.R. 683, 698 (Bankr.E.D.Mo. 1990)(former shareholders could participate under plan as unsecured creditors); *In re Sherwood Square Associates*, 107 B.R. 872, 887 (Bankr.D.Md. 1989)(allowed administrative expense claims of insiders were entitled to repayment and could be offset against new capital contribution).

An old equity holder may receive payment for

goods or services provided to the Debtor as an administrative claim or receive payment on an unsecured claim without violating the absolute priority rule. By the same logic, an old equity holder who makes a new contribution may participate in the Plan based on that new contribution without regard to its former interest.

Phoenix contends that because the statutory language does not expressly adopt the new capital doctrine, that Congress must have meant to exclude it. However, the definition of "fair and equitable" in § 1129(b)(2) is only a partial definition as shown by use of word "includes."

The term "fair and equitable" under the Bankruptcy Act included both the absolute priority rule and the new capital doctrine. Because "fair and equitable" had an established meaning at the time it was enacted into the Bankruptcy Code, it is presumed that

Congress intended to adopt the established judicial construction as well. "(W)here words are employed in an act which had at the time a well-known meaning in the law, they are used in that sense unless the context requires the contrary." *Case v. Los Angeles Lumber Products Company*, 308 U.S. at 115, 60 S.Ct. at 7.

> The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of the judicially created concept, it makes that intent specific (citation omitted). The Court has followed this rule with particular care in construing the scope of bankruptcy codifications.

Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494, 501, 106 S.Ct. 755, 759 (1986).

Under the Bankruptcy Act, "fair and equitable"

referred to a priority scheme where senior interests could not be forced to give up rights to junior interests without adequate compensation.

> "Fair and equitable," taken from § 77B and made the condition of confirmation under both Chapter X or XI are "words of art", having a well understood meaning in reorganizations, in equitable receiverships and under § 77B which is incorporated in the structure of both Chapter X and XI (citation omitted). The phrase signifies that the Plan or arrangement must conform to the rule of *Northern Pacific Railway Company v. Boyd* (citation omitted), which established the principle which we recently applied in the *Los Angeles* case, that in any plan of corporate reorganization, unsecured creditors are entitled to priority over

> stockholders to the full extent of their debts and that any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of stockholders is inadmissible.

Securities and Exchange Commission v. United States Realty and Improvements Company, 310 U.S. 434, 452, 60 S.Ct. 1044, 1051-52 (1940)(emphasis added).

However, the Supreme Court also stated that the definition of "fair and equitable" included practical considerations:

> In application of this rule of full or absolute priority, this Court recognized certain practical considerations and made it clear that such rule did not "require the impossible, and make it necessary to pay an unsecured creditor in cash as a condition of stockholders retaining an interest in the

reorganized company."

Case v. Los Angeles Lumber Products Company, 308 U.S. at 117, 60 S.Ct. at 8.

This Court elaborated upon these practical considerations as follows:

> It is, of course, clear that there are circumstances under which stockholders may participate in a Plan of Reorganization of an insolvent debtor. This Court, as we have seen, indicated as much in *Northern Pacific Railway Company v. Boyd*, *supra*, and *Kansas City Terminal Railway Company v. Central Union Trust Company*, *supra*. Especially in the latter case did this Court stress the necessity, at times, of seeking new money "essential to the success of the undertaking" from the old stockholders. Where that necessity exists

> and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.
>
> . . . .
>
> In view of these considerations, we believe that to accord "the creditor his full right of priority against the corporate assets" where the debtor is insolvent, the stockholders' participation must be based on a contribution in money or money's worth reasonably equivalent in view of all the circumstances to the participation of the stockholder.

Case v. Los Angeles Lumber Products Company, 308 U.S. at 121, 122, 60 S.Ct. at 10.

Thus, the concept of "fair and equitable" under the Bankruptcy Act included both the requirement that

senior creditors receive priority to junior creditors or interests and the opportunity for old equity to participate based upon a fresh contribution of capital which is necessary to the success of the reorganization.

A panel of the Seventh Circuit has recently suggested that the new capital doctrine is simply a corollary to the absolute priority rule:

> In addition, several commentators have recently argued powerfully that the new value "exception" is not an exception at all, but is consistent with the absolute priority rule as codified in § 1129(b). See Brief of Elizabeth Warren as Amicus Curiae at 4-11, In re Greystone III Joint Venture, 948 F.2d 134 (5th Cir. 1991) (No. 90-8529) (additional citations omitted). Section 1129 bars old equity from receiving an interest under the plan "on account of" its prior

> equitable ownership. But when owners infuse necessary new value into the enterprise in the form of money or money's worth, the source of their retained interest is not their prior ownership, but rather their new contribution. If, as these authorities contend, the new value "exception" is not an exception but a corollary to the absolute priority rule, then it must have survived enactment of the 1978 Code.

Matter of Snyder, ___F.2d ___, 1992 WL 156687 (7th Cir. 1992).

In its original Opinion, the Fifth Circuit dismissed Greystone's statutory arguments, stating:

> This argument holds that if "old equity" infuses new money into the Debtor, it is not retaining its ownership "on account of" its old equity status. This is mere word play,

> because Greystone intends to prevent creditors from acceding to ownership of the property on account of Greystone's unique status as an old equity contributor to the Plan. More specifically, Greystone desired to prevent a competitive auction of the property, at which Phoenix could credit bid, precisely because of Greystone's old equity status. Greystone cannot read the statutory language in such a self-serving way.

Appendix to Greystone Petition, A-35 to 36.

Under the Fifth Circuit's initial Opinion, any Plan proposed by old equity is per se "on account of" its old equity status. In other words, because the Code allows the former equity holders to propose a Plan which might provide for them to contribute new capital, any interest provided under that Plan is based upon the old equity

"status" rather than the new capital. However, this analysis introduces a new word into the statute. The statute does not refer to old equity "status," but to "such junior claim or interest." Further, practice under the Bankruptcy Act specifically distinguished between receiving property on account of a new capital contribution and retaining property on account of an old interest. A plan which proposes to cancel the old interests and issue new interests based upon a fresh contribution of capital does not violate the absolute priority rule. The mere fact that the Code allows the Debtor to propose a plan does not change the capital contribution into an interest retained "on account of" a former equity interest.

The Fifth Circuit also objected to what it perceived as the debtor's desire to prevent a competitive auction. However, here, the Fifth Circuit mixed two concepts. Under 11 U.S.C. § 363(k), a secured creditor may credit

bid in a sale of property upon which it holds a lien. In this case, the creditor did not hold a lien upon the debtor entity itself. As this Court made clear in *Norwest Bank Worthington v. Ahlers*, the property interest which a debtor may not retain under the absolute priority rule is the right to remain in control of the business. Since this right is not an asset upon which Phoenix had a lien, it would not have been entitled to make a credit bid.

Further, the Fifth Circuit's concern that the Debtor was subverting the right to a competitive auction ignores the fact that there is no provision in either the statutory language or the history of the term "fair and equitable" providing for a competitive auction. Instead, the Code provides for a party in interest to propose a plan and for the Court to determine whether that plan may be confirmed. *In re Greystone III Joint Venture*, 102 B.R. 560, 577, n. 22 (Bankr.W.D.Tex. 1989).

The Fifth Circuit's initial interpretation of the

absolute priority rule was not warranted by the language of the statute or the judicially-established meaning of the term "fair and equitable." Old equity is not prohibited from participating in a plan based upon its "status" or its right to propose a plan under the Code. It is only participation based upon a "junior claim or interest" which is condemned. Similarly, it is not the function of the appellate courts to create new requirements for confirmation, such as a right to credit bid upon the equity of the debtor. The Fifth Circuit was justified in withdrawing its original opinion. This Court should conclude that the new capital doctrine remains viable under the Code.

CONCLUSION

Both Greystone and Phoenix are in agreement that the Court should grant the Cross-Petition for Writ of Certiorari. This is an important issue upon which the Courts of Appeals are divided. Greystone would also

point out that in order to reach the Cross-Petition, it is necessary to grant the Petition in Case Number 91-1902, *Greystone III Joint Venture, Petitioner v. Phoenix Mutual Life Insurance Company, Respondent.*

Once the Cross-Petition is granted, the parties disagree upon the ultimate result. The issue is one of congressional intent. The text of the Bankruptcy Code does not prohibit or restrict the new capital doctrine. The history under the Bankruptcy Act shows that the new capital doctrine plays a useful and practical role in reorganizations. Therefore, upon granting the Cross-Petition for Writ of Certiorari, this Honorable Court should find that the new capital doctrine survived and was satisfied in the present case.

Respectfully submitted,

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